

Message Text

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ACTION EB-04

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R 191251Z DEC 77
FM AMEMBASSY LONDON
TO TREASURY DEPT WASHDC
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INFO AMEMBASSY BONN
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 20553

LIMDIS GREENBACK

USOECN ALSO FOR EMBASSY

E.O. 11652: XGDS-1
TAGS: EFIN, UK
SUBJECT: HMTREASURY ON INTERNATIONAL MONETARY SITUATION

REF: LONDON 19266

SUMMARY: SENIOR H.M. TREASURY OFFICIAL IS NOT OPTIMISTIC
ON OUTLOOK FOR 1978, BUT AT LEAST HOPES THINGS WON'T GET
WORSE. END SUMMARY

1. TREASURY REPRESENTATIVES HAD END OF YEAR TOUR D'HORIZ-
ON WITH KEN COUZENS, SECOND PERMANENT SECRETARY, H.M.
TREASURY. COUZENS SUMMARIZED HIS MAJOR GENERAL CONCERNS
AS FOLLOWS: LOOKING TO 1978, HE AGAIN SEES THE U.S.
PROVIDING THE MAIN ENGINE OF INDUSTRIAL WORLD GROWTH. HE
FEARS 1978 WILL BE MORE OF THE SAME OR EVEN WORSE THAN IN
1977. REFERRING TO THE RECENT VISIT OF FRENCH PRESIDENT
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GISCARD D'ESTAING AND PRIME MINISTER BARRE, HE SAID THE
FRENCH SHARE THESE VIEWS. IN 1978 GERMAN GROWTH RATE IS
NOT SEEN AT MUCH MORE THAN 3 PERCENT. WHATEVER THE JAPA-
NESE DO, THEIR TRADE SURPLUS WILL STILL BE IN AN \$8-\$10
BILLION RANGE. WITHIN THE NEXT FEW WEEKS, THE UK MAY HAVE
ANOTHER GO AT THE GERMANS IN AN ATTEMPT TO CONVINCE
THEM OF THE NEED FOR A GREATER STIMULUS TO THEIR ECONOMY.

2. REFERRING TO THE JAPANESE, COUZENS SAID HE WISHED THERE WAS A MORE COORDINATED APPROACH BETWEEN EC AND US EFFORTS. IT IS ALL RIGHT FOR THE US TO TELL THE EUROPEANS THAT IN OUR BILATERAL APPROACHES WITH THE JAPANESE WE HAVE THEIR BEST INTERESTS IN MIND. THE EUROPEANS ARE SKEPTICAL. THE EC SENDS JENKINS TO TALK TO THE JAPANESE WHO IS TOLD THAT THE JAPANESE ARE TALKING TO THE AMERICANS ON SIMILAR POINTS. COUZENS FEARS THE JAPANESE ARE PLAYING OFF ONE SIDE AGAINST THE OTHER. IN HIS VIEW, UNTIL THERE IS A COORDINATED APPROACH BETWEEN THE EC AND THE U.S., THE EC HEADS OF GOVERNMENT WILL NOT STAKE THEIR OWN PRESTIGE OR INFLUENCE ON A HIGH LEVEL APPROACH TO THE JAPANESE. HE AGREES FULLY WITH THE U.S. VIEWS THAT THE JAPANESE DISTRIBUTION SYSTEM NEEDS TO BE REVISED AND IMPROVED. THIS IS IN THE BEST INTERESTS OF THE JAPANESE ALTHOUGH IT WILL REQUIRE A LONG-TERM EFFORT. THE SOONER THE JAPANESE START THE BETTER. COUZENS HAS AN INCREASING SENSE OF FRUSTRATION WITH THE JAPANESE. IN ADDITION, HE BELIEVES THEY WILL SEE AN INCREASING CIRCLE OF PROTECTIONISM GO UP AGAINST THEM. IN AUSTRALIA THIS IS ALMOST A CERTAINTY GIVEN THE RESULTS OF THE RECENT ELECTION.

3. TURNING TO FOREIGN EXCHANGE DEVELOPMENTS, COUZENS SAID H.M. TREASURY AND CHANCELLOR HEALEY WOULD VERY MUCH LIKE A PERIOD OF STABILITY. THEY RECOGNIZE IT IS MOST CONFIDENTIAL

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UNLIKELY TO HAPPEN GIVEN THE DIFFERING STAGES OF THE BUSINESS CYCLE IN WHICH MAJOR ECONOMIES FIND THEMSELVES. HMT IS STILL CONCERNED WITH THE "ATOMIC CLOUD" (SEE REFTEL) OF CAPITAL MOVEMENTS. REPEATING HIS EARLIER COMMENTS REPORTED REFTEL, COUZENS SEES THE THREE MAJOR ELEMENTS IN SHORT-TERM VOLATILE CAPITAL MOVEMENTS: THE LEADS AND LAGS OF MULTINATIONAL CORPORATIONS; LIQUID FUNDS AVAILABLE IN THE EURO CURRENCY MARKET; AND UNDERLYING PAYMENTS IMBALANCES WHICH INCLUDE THE SURPLUSES OF OPEC, GERMANY AND JAPAN

4. OF THESE THREE ELEMENTS, HE FELT THERE POSSIBLY MIGHT BE SOME IMPROVEMENT OR ELEMENT OF CONTROL THAT COULD BE INTRODUCED INTO THE EURO CURRENCY MARKET. HE ESCHEWED TECHNICAL COMPETENCE IN THE AREA, SAYING KIT MCMAHON, DIRECTOR OF THE BANK OF ENGLAND, UNDERSTOOD IT MUCH BETTER THAN HE, BUT EVEN IF SOMETHING COULD BE WORKED OUT IT PROBABLY WOULDN'T GREATLY CHANGE THE EXISTING SITUATION. THE SYSTEM IS OUT OF PHASE. IF THE GERMAN AND JAPANESE ECONOMIES WERE IN EXPANSION--MORE IN HARMONY WITH THE US--IF INTEREST RATES COULD BE ALIGNED, THEN SOMETHING MORE MIGHT BE DONE TO CONTROL THE FLOWS. INTERVENTION IN FOREIGN EXCHANGE MARKETS IN THOSE CIRCUMSTANCES MIGHT BE

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C O N F I D E N T I A L SECTION 02 OF 02 LONDON 20553

LIMDIS GREENBACK

EFFECTIVE. AT THE MOMENT HOWEVER INTERVENTION TO DEFEND PARTICULAR RATES WOULD PROBABLY RUN COUNTER TO BASIC MARKET FORCES. THERE WAS AN ALLUSION TO CHANCELLOR HEALEY'S INTERVIEW IN THE DECEMBER ISSUE OF EUROMONEY MAGAZINE WHICH WAS GIVEN ON NOVEMBER 1 IN WHICH HE SAID THE SIZE OF THE AMERICAN DEFICIT DID NOT DISTURB HIM AND THAT THE U.S. HAD BEEN VERY SENSIBLE IN TAKING A FAIR SHARE OF THE OIL CONSUMING COUNTRIES DEFICIT.

5. THE CHANCELLOR, IN COUZENS OPINION, ACCEPTS THAT WITH MAJOR COUNTRIES OUT OF PHASE IN A BUSINESS CYCLE, THE EXCHANGE MARKETS WILL NOT BE STABLE REGARDLESS OF THE UK AND CHANCELLOR'S DESIRE FOR STABILITY.

6. TOUCHING BRIEFLY ON HMT EXCHANGE RATE POLICY, COUZENS SAID THAT THE UK DOES NOT PLAN TO PUT A CAP ON STERLING; "WE WILL NOT GIVE AN INDEFINITE PROMISE FOR THE FUTURE" BUT WE HAVE NO INTENTION OF CAPPING IT NOW.

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7. IN REPLY TO OTHER QUESTIONS, COUZENS SAID THE UK DOES VERY MUCH WANT TO HONOR ITS BASLE AGREEMENT COMMITMENTS TO GET OUT OF THE RESERVE CURRENCY GAME. ONE PROBLEM IS THE LARGE CAPITAL INFLOWS AND THE SIZE OF THE UK DEBT MARKETS. FOREIGN OFFICIAL FUNDS CAN FLOW IN AND THERE IS VERY LITTLE THE UK FEELS IT CAN EFFECTIVELY DO TO DISCOURAGE IT.

8. IN REPLY, US TREASURY REPRESENTATIVES ASKED WHY THE UK DID NOT REMOVE FOREIGN EXCHANGE CONTROLS TO ALLOW THE FUNDS TO MOVE OUT AGAIN AND RELIEVE UPWARD PRESSURE ON THE EXCHANGE RATE. COUZENS APPEARED SLIGHTLY EXASPERATED AT THIS POINT, HAVING EARLIER INDICATED (SEE REFTEL) THAT THE PROBLEM AND ITS EVENTUAL SOLUTION IS AT THE MINISTERIAL LEVEL AND NOT WITH HIM. HE ADDED HOWEVER THAT HE HAD ARGUED STRONGLY AND WON THE ARGUMENT AGAINST AGAIN PERMITTING STERLING FINANCING OF THIRD COUNTRY TRADE. IN ORDER TO GET OUT OF THE RESERVE CURRENCY GAME, HE BELIEVED IT NECESSARY TO PROHIBIT WHENEVER POSSIBLE ALLOWING OTHER COUNTRIES TO HAVE ACCESS TO ONE'S CURRENCY FOR THIRD COUNTRY OPERATIONS EVEN IF OSTENSIBLY LINKED TO TRADE. PREVIOUSLY, THE JAPANESE HAD BOUGHT AUSTRALIAN WOOL USING POUNDS, AS A MEANS OF SPECULATING AGAINST THE POUND THROUGH COMMODITIES. HE DID NOT WANT TO OPEN A DOOR THAT WOULD ENABLE FOREIGN FIRMS TO LEAD AND LAG AGAINST STERLING (FYI ALTHOUGH WE KNOW THERE ARE OTHERS IN THE BANK OF ENGLAND WHO TAKE A DIFFERENT VIEW, SEEING THIS AS ONE MEANS OF RELIEVING UPWARD PRESSURE ON THE CURRENCY WHICH CAN BE REVERSED IF NECESSARY IN A GIVEN TIME PERIOD.)

9. REFERRING TO THE CHANCELLOR'S IMF LETTER, COUZENS THOUGHT THAT THE U.S. WOULD FIND IT BORING AND OF LITTLE CONFIDENTIAL

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INTEREST.

10. REFERRING TO THE ERRONEOUS DOW-JONES REPORT WHICH LINKED COMMENTS IN THE DECEMBER BANK OF ENGLAND QUARTERLY CONCERNING POLICIES OF COMPETITIVE EXCHANGE RATE DEPRECIATION BEING SELF DEFEATING AND THE IMPOSITION OF TRADE RESTRICTIONS BY ONE MAJOR COUNTRY PROMOTING AN AVALANCHE OF IMITATIONS TO THE U.S., COUZENS ABJURED ANY DELIBERATE INTENTION TO LINK THESE SENTIMENTS WITH U.S. POLICY. WHEN HE READ THEM, HE ASSUMED IN HIS OWN MIND THE BANK WAS POINTING A WARNING FINGER AT THOSE IN HMG, THE LEFT-WING OF THE LABOR PARTY AND THE TUC WHO HAVE

BEEN ARGUING IN FAVOR OF THE IMPOSITIONS OF SUCH POLICIES.

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